CHAPTER 5
AUSTRALIA

Introduction. The worst appears to be over for the Australian economy. The bad news is giving way to good news.

- After negative economic indicators in 4Q00 and 1Q01, economic indicators turned positive in the summer of 2001.

Economic Bad News

Let's turn first to the bad news starting back in late 2000/early 2001.

Contraction. This past decade Aussie annual economic growth rate averaged more than 4% for nine years in a row—a better record than even the United States.

- But in 4Q00, Australia had its first contraction in 10 years of -0.6%.

Negative Drivers. Why the contraction? A number of factors depressed demand in 4Q00. These included:

- Higher taxes.
- Central Bank slamming on the brakes (with excessively higher interest rates to overkill suspected inflation from Olympic overspending).
- These negative drivers more than offset rising commodity prices.

Foreign Exchange Falls. The currency is grossly undervalued. Traditional relationships, such as movements in commodity prices, have unraveled.

- At 52 U.S. cents per Australian dollar, it is trading at 26% below its average of 70 U.S. cents over the past decade.
- The currency fell 13% in the first three months of 2001.

Currency Drivers. Why did the Aussie dollar get so weak?

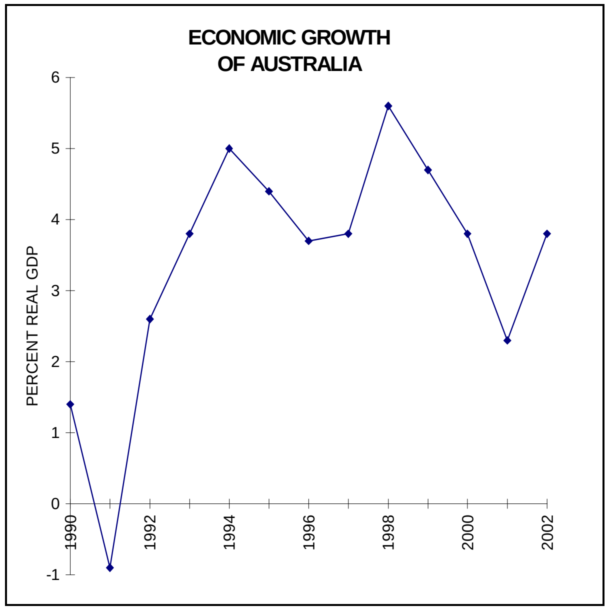
- *Weak International Demand.* The two most important Aussie trading partners—the United States and Japan—are both struggling, thus providing little aggregate demand for Aussie exports. That means little commercial demand for the Aussie dollar.

Figure 5-A. Selected Historical Data

$ Billions (or %)	'97	'98	'99	'00
Gross National Income	382.7	380.6	380.8	394.0
Purchasing Power	362	377.4	426.4	501.5
Growth (%)	3.8	5.6	4.7	3.8
Inflation (%)	0.3	0.9	1.5	4.5
Exports	64.9	59.1	59.4	66.8
To U.S.	4.9	5.7	5.8	6.7
Imports	59.2	59.0	61.7	66.6
From U.S.	12.0	11.9	11.3	12.3
FDI from U.S.	26.1	33.7	34.8	35.3
In U.S.	11.7	10.5	13.2	14.5
Cur Account /GDP %	-12.8	-17.2	-18.6	..
Fiscal Balance /GDP %	-0.1	0.3	0.9	0.9
External Debt /GDP %	..	..	..	..

Sources: IMF, World Bank, U.S. Commerce

Figure 5-B



- *Net Capital Outflow.* Financial factors are weakening the Aussie dollar. Capital inflows into Australia—both stock money as well as foreign direct investment—have fallen.[1] Local fund managers are diverting more Aussie investments abroad. In 2000, Aussie investors bought more and more U.S. stocks. In 2001 Aussie investors bought more and more U.S. government securities. All these trends reduced the demand for the Aussie dollar.

*Bungled Tax Reform**.*** The political economy in Australia has never really recovered from the introduction a year ago of a new tax system. The centerpiece was a tax on most goods and services in exchange for lower income and corporation taxes.

- The reforms were overdue, but it was poorly implemented.
- Small businesses complained about the high costs of complying with it.
- Elderly Australians on fixed incomes felt left out of the prosperity being enjoyed by younger wage earners.
- The budget surplus was whittled down to just A$1.5B (US $780M).
- Spending on new measures rose to A$4B.
- The budget also committed more money to help small businessmen buy cars, the unemployed to find jobs, and people in the countryside to get health care.

Saying No to Shell. In April 2001 the government rejected Shell's bid for Woodside Petroleum, Australia's largest-listed oil and gas group.

- The government turned down Royal Dutch/Shell's A$10B bid for Woodside, the country's largest independent oil and gas group. Shell was seeking to lift its stake in Woodside from 34% to 56%.
- The decision locked out a foreign company from one of the most important asset sales in many years.

Mixed Reviews. On the one hand, those Aussies who feel they are helpless victims of globalization generally supported the rejection of Shell. On the other hand, the market reacted negatively with the perception that the government was retreating from an open economy.

- The decision certainly was not received well outside of Australia. The currency and stock prices fell on 23 April 2001 announcement.
- It further alienated international investors, who tend to dismiss Australia as an old economy. The decision also reinforced growing fears that an isolated Australia will be a loser from globalization. In short, investors feel that it will harm Aussie economic fortunes.
- The decision also sets a bad example to developing economies across Asia as they struggle to reconcile the need for growth with a resurgence of anti-globalization sentiment.

Economic Good News

But all is not gloom and doom. Recent economic indicators are positive. In other words, the worst may be over.

- Growth for the year 2001 was 2.3%.
- Australian consumer confidence increased by a record 14.8% in June to 108.4, its highest level since August last year.
- Business confidence is also picking up. Building approvals have been strong.
- The current account deficit shrank from 6.1% of GDP in September 1999 to 1.6% in September 2001.

Rising Farm Production. Australian dollar grain and oilseeds prices are soaring.

- Australian wheat prices are trading at record levels. Barley prices are at records and canola (cooking oil) is near its all-time highs.
- Livestock prices are also high.
- The net value of farm production is forecast to rise nearly 16% in 2001-02 following a 34% increase last year.

Rising Export Earnings. Australia’s commodity exports are set to rise 5% to a record A$92.6B (US $48.4B) in 2001/02.

- This is the third consecutive year of record commodity exports and the expected 2001/02 increase would follow a 23% rise last year to A$88.6B.
- Exports are booming mainly because of the persistently weak in Australian dollar.
- But exports are expected to rise in 2002.

Rebound in Housing. Australia showed an unexpectedly sharp rebound in housing, a sector that had been a drag on the economy for several months. Lower interest rates and an expanded first-home owner's scheme have lit the fuse under housing construction.

The U.S. Economic Factor. Therefore, the worst appears to be over for the Aussie economy. But it's too early to celebrate a durable recovery. At a minimum, the durability of this upswing will be severely tested by U.S. economic stagnation and recession seeping across other Asian economies.

Conclusion

The poor Aussie economic performance that the country experienced in the fourth quarter of 2000 and first quarter of 2001 is giving way to good news in recent months.

- On the negative side, the Australian dollar is at a new low of 52 U.S. cents.
- On the positive side, the economy is back on the growth track with GDP up 2.3%.
- Consumer and business confidence are both picking up. Grain prices are rising, export earnings are improving and housing is on the rebound.
- Stagnation and recession in the United States, Japan, and the rest of Asia are still causes for concern.

How has the Australian government managed the economy?

- Over the last decade or so, the Aussie government's management of the economy has generally been positive. Its economic reforms establish a strong foundation for long term economic growth.
- Of course, the economic contraction and the fall in the Australian dollar made things politically difficult for the government. In 2001 popular support for the government coalition was at its lowest level since 1994.

On the other hand, the Aussie economic governance could have been better.

- The government coalition has taken only a few actions to reduce the budget surplus.
- Further, the government also rejected Shell's bid to buy Woodside Petroleum.
- The market is concerned about how some of the government's recent policies alienate U.S. and other foreign investors.
- The market would prefer to see the Aussies follow economic policies that attract and retain foreign investment, thus strengthening the Australian dollar in the process.

Endnotes

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[1] To be fair, the stock of foreign direct investment in Australia still remains higher than direct investment by Australian companies overseas. However, the outward flow is increasing faster than the inward flow.